

the principal office of the NASD. All submissions should refer to File No. SR-NASD-98-95 and should be submitted by January 26, 1999.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>8</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

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## SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40853; File No. SR-NASD-98-57]

### Self-Regulatory Organizations; Order Granting Approval to Proposed Rule Change and Amendment Nos. 1 and 2, and Order Granting Accelerated Approval to Amendment No. 5 Thereto, by the National Association of Securities Dealers, Inc. Relating to Amendments to NASD Membership and Registration, Investigation and Sanctions, Conduct and Code of Procedure Rules

December 28, 1998.

#### I. Introduction

On August 7, 1998, the National Association of Securities Dealers, Inc. ("NASD" or "Association"), through its regulatory subsidiary, NASD Regulation, Inc. ("NASD Regulation") submitted to the Securities and Exchange Commission ("SEC" or "Commission"), pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934 ("Act")<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> a proposed rule change to amend the NASD Membership and Registration, Investigation and Sanctions, Conduct and Code of Procedures rules. The proposed rule change was amended on August 17, 1998,<sup>3</sup> and further amended on August 26, 1998.<sup>4</sup> These amendments both clarified and corrected the language of the proposal.<sup>5</sup>

<sup>8</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Letter from Joan C. Conley, Secretary, NASD Regulation to Katherine A. England, Assistant Director, Division of Market Regulation ("Division"), SEC, dated August 17, 1998 ("Amendment No. 1").

<sup>4</sup> E-mail from Eric Moss, Attorney, NASD Regulation to Mandy Cohen, Attorney, Division, SEC, dated August 26, 1998 ("Amendment No. 2").

<sup>5</sup> In addition, on September 25, 1998 and October 30, 1998, NASD Regulation filed nonstantive amendments granting extensions of time for Commission action. See Letters from Eric Moss, Attorney, NASD Regulation to Katherine A. England, Assistant Director, Division, SEC, dated September 25, 1998 and October 29, 1998 ("Amendment No. 3 and Amendment No. 4,"

On November 13, 1998,<sup>6</sup> the NASD further amended the proposal, to respond to suggestions in a comment letter.<sup>7 8</sup>

The proposed rule change was published for comment in the Federal Register on September 3, 1998.<sup>9</sup> One comment letter was received on the proposal.<sup>10</sup> This Order approves the proposed rule change, as amended and grants accelerated approval to Amendment No. 5 to the proposed rule change.<sup>11</sup>

#### II. Background

In November 1994, the NASD Board of Governors appointed the Select Committee on Structure and Governance ("Select Committee") to review the NASD's corporate governance structure and to recommend changes to enable the NASD to better meet its regulatory and business obligations, including its oversight of the Nasdaq market.

On August 8, 1996, the Commission issued an order pursuant to Section 19(h)(1) of the Act<sup>12</sup> ("SEC Order"),<sup>13</sup>

respectively). On December 22, 1998, the NASD filed another non-substantive amendment changing the effective date of the proposed rule change to 30 days after publication of the proposal in the NASD Notices to Members. Letter from Alden S. Adkins, Sr. Vice President and General Counsel, NASD Regulation to Katherine A. England, Assistant Director, Division, SEC, dated December 22, 1998 ("Amendment No. 6").

<sup>6</sup> Letter from Alden S. Adkins, Sr. Vice President and General Counsel, NASD Regulation to Katherine A. England, Assistant Director, Division, SEC, dated November 10, 1998 (Amendment No. 5").

<sup>7</sup> This comment letter is more fully discussed below in Section IV, *Comments and Responses*. See Letter from Anne C. Flannery and Ben A. Indek, Morgan Lewis & Bockius, LLP, to Jonathan G. Katz, Secretary, SEC, dated October 6, 1998 ("Flannery Letter").

<sup>8</sup> The NASD again agreed to extend the time for Commission action by letter from Eric Moss, Office of General Counsel, NASD Regulation to Katherine A. England, Assistant Director, Division, SEC, dated November 30, 1998.

<sup>9</sup> Securities Exchange Act Release No. 40378 (August 27, 1998), 63 FR 47064 (September 3, 1998). Amendment Nos. 1 and 2 were included in this release.

<sup>10</sup> See *supra* note 7, and *infra* Section IV, *Comments and Responses*.

<sup>11</sup> The Commission also solicits comments on Amendment No. 5. Amendment Nos. 3 and 4, which extend the time for Commission action, are non-sustantive, and therefore do not require publication for notice and comment. Amendment No. 6 is also non-substantive, and therefore does not require publication for notice and comment.

<sup>12</sup> 15 U.S.C. 78s(h)(1).

<sup>13</sup> Securities Exchange Act Release No. 37538 (August 8, 1996), SEC's Order Instituting Public Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, In the Matter of the National Association of Securities Dealers, Inc. Administrative Proceeding File No. 3-9056. Section 21(a) of the Act is set forth at 15 U.S.C. 78u(a).

<sup>14</sup> SEC, Report and Appendix to Report Pursuant to Section 21(a) of the Securities Exchange Act of

including fourteen undertakings ("Undertakings"), and a related report pursuant to Section 21(a) of the Act ("21(a) Report").<sup>14</sup> In these documents, the Commission indicated that the NASD had not complied with its own rules and had failed to satisfy its self-regulatory obligations under the Act to enforce such rules and the federal securities laws. Shortly thereafter, following the recommendations of the Select Committee, the NASD proposed to reorganize its corporate structure. The NASD retained ultimate policymaking, oversight, and corporate authority as the parent holding company and statutory self-regulatory organization, while granting substantial deference to the operating subsidiaries in the areas of their respective jurisdictions. Nasdaq was given sole responsibility to operate and oversee the Nasdaq market and other over-the-counter markets, while NASD Regulation was given responsibility for regulation and member and constituent services. The Rules of the Association ("Rules"), including those sections governing the conduct and review of disciplinary proceedings, member admissions procedures and denial of access decisions, were substantially revised. The revisions to the corporate structure were first proposed and adopted in mid-1996 and were approved by the Commission on August 7, 1997,<sup>15</sup> Additional revisions to the corporate structure were approved on November 14, 1997,<sup>16</sup> and in the months following,<sup>17</sup> while various other proposals, including revision of the procedures governing the automated systems, are still pending.<sup>18</sup> The proposed amendments supplement previous changes to the Rules of the Associations adopted in response to the SEC Order and related documents.

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<sup>12</sup> 15 U.S.C. 78s(h)(1).

<sup>13</sup> Securities Exchange Act Release No. 37538 (August 8, 1996), SEC's Order Instituting Public Proceedings Pursuant to Section 19(h)(1) of the Securities Exchange Act of 1934, Making Findings and Imposing Remedial Sanctions, In the Matter of the National Association of Securities Dealers, Inc. Administrative Proceeding File No. 3-9056. Section 21(a) of the Act is set forth at 15 U.S.C. 78u(a).

<sup>14</sup> SEC, Report and Appendix to Report Pursuant to Section 21(a) of the Securities Exchange Act of 1934 Regarding the NASD and the Nasdaq Stock Market (August 8, 1996).

<sup>15</sup> Securities Exchange Act Release No. 38908 (August 7, 1997) 62 FR 43385 (August 13, 1997) (File No. SR-NASD-97-28).

<sup>16</sup> Securities Exchange Act Release No. 39326 (November 14, 1997) 62 FR 62385 (November 21, 1997) (File No. SR-NASD-97-71).

### III. Description of the Proposal

NASD Regulation is proposing changes to the Rules of the Association that include: (A) the amendment and consolidation of certain non-summary procedures in the Rule 9510 Series, including those related to failure to provide information, statutory disqualification and failure to pay dues and fines; (B) the streamlining of default decisions, by measures including the consolidation of various procedures into a single rule series and the revision of review procedures; (C) the modification of pre-use filing requirements for advertising materials; (D) the refinement of certain elements of the Association's non-summary disciplinary processes, including amendment of complaints and the introduction of new evidence upon review; (E) the revision of various procedural technicalities, including the issuance of decisions in settled cases, the effective date of certain sanctions, and several others.

#### A. Refinement of Non-Summary Procedures

According to NASD Regulation, in a summary proceeding, the Association may impose a suspension, limitation, or prohibition before holding a hearing. In a non-summary proceeding, a respondent is given notice and an opportunity for a hearing before the Association takes any action against a respondent. In this proposal, the NASD has reorganized and simplified its rules by grouping procedures by type—a "summary proceeding" or a "non-summary proceeding"—rather than by the issue or malfeasance addressed by the particular rule.

#### 1. Denials of Access, Failure To Pay Arbitration or Settlement Awards and Imposition of Pre-Use Advertising Requirements

As approved today, the Rule 9510 Series will be simplified by deleting certain non-summary proceedings, consolidating them with other rules, and by replacing certain current procedures with simpler measures located in other parts of the Rules. This proposal refines the scope of the Rule 9510 Series and removes redundant provisions. As revised, this series will govern summary proceedings authorized by Section 15A(h)(3) of the Act, including statutory disqualification and failure to provide information; and non-summary proceedings imposing suspension or cancellation for failure to comply with an Association arbitration award or a settlement agreement, limitation or denial of access to Association systems, such as the Nasdaq

workstation, and an advertising pre-use filing requirement.<sup>19</sup> Finally, the rule series will be amended to clarify that the Association may, rather than shall, initiate non-summary proceedings, to more accurately reflect the NASD's prosecutorial discretion.<sup>20</sup>

#### 2. Suspension and Cancellation for Failure To Provide Information

a. *Procedural Changes.* the procedures addressing a member or associated person's failure to provide requested information are currently located in both the Rule 9510 and 8220 Series. As proposed, these sections will be consolidated in a revised Rule 8220 Series.

Currently, the Rule 8220 Series authorizes the national Adjudicatory Council ("NAC") to initiate a suspension proceeding for failure to provide requested information, while the Rule 9510 Series authorizes similar action for the same purpose. As amended, only the Department of Enforcement of NASD Regulation, acting under Board-delegated authority, will be responsible for initiating these proceedings, and will be designated as a party in the subsequent proceedings.<sup>21</sup> NASD Regulation points out that this is consistent with the Department of Enforcement's authority in disciplinary proceedings governed by the rule 9200 Series.<sup>22</sup>

The proposed changes to the Rule 8220 series amend several hearing procedures. First, under proposed Rule 8222(a), a member or associated person may file a request for hearing directly with the NASD Regulation Office of General Counsel, that is responsible for arranging such hearings, rather than the NAC, as currently required.

Second, proposed Rule 8222(b)(1) expands the pool of persons eligible for serving on the subcommittee conducting

the hearings. Previously, only former members of the NASD Regulation Board of Directors, and the NASD Board of Directors could serve with current and former NAC members on the subcommittee. The proposal adds current members of these boards to the pool. At least one member, however, will have to be a current NAC member.

Third, proposed Rule 8222(b)(92) lengthens the period during which a hearing must be held, from 20 to 30 days. NASD Regulation represents that 20 days is not sufficient time to find panelists and coordinate the schedules of the panelists, the parties, and their attorneys. NASD Regulation asserts that the increased time period will not prejudice the member or associated person because once a hearing is requested, a suspension or cancellation is stayed pending completion of the proceeding.

Fourth, Rule 8222(b)(3), as amended by the proposal, will allow the Association to withhold certain privileged documents, such as attorney work product.<sup>23</sup>

Fifth, the proposed Rule 8222(b)(7) requires that any additional information required by a hearing subcommittee be distributed to the parties not less than one business day before the subcommittee renders its decision.

Finally, the Rule 8220 Series is revised to require service by overnight commercial courier. NASD Regulation believes this will ensure efficient service.

b. *Call for Review.* Proposed Rule 8223(b) revises the call for review process by placing the authority to conduct a review with a review panel, rather than the full NASD Board. NASD Regulation believes the proposed rule change will permit suspension or cancellation proceedings to be concluded in a more timely manner. The NASD Board Executive Committee is a smaller body designed to meet on an as-needed basis and can convene more easily than the NASD Board. A review by the NASD Board is generally deferred until the next NASD Board meeting, which could be as much as two months later.<sup>24</sup> The review panel in most cases could conveniently arrange its review around the Executive Committee meetings because most of the participants would be the same.

The ability of any Governor to call the proceeding for review remains intact. The review panel will be composed of

<sup>17</sup> Securities Exchange Act Release No. 39470 (December 19, 1997), 62 FR 67197 (December 30, 1997) (File No. SR-NASD-97-81); Securities Exchange Act Release No. 39483 (December 22, 1997), 63 FR 117 (January 2, 1998) (File No. SR-NASD-97-90); Securities Exchange Act Release No. 39494 (December 29, 1997), 63 FR 586 (January 6, 1998) (File No. SR-NASD-97-97); Securities Exchange Act Release No. 39671 (February 17, 1998), 63 FR 9893 (February 26, 1998) (File No. SR-NASD-98-13); Securities Exchange Act Release No. 40213 (July 15, 1998), 63 FR 39619 (July 23, 1998) (File No. SR-NASD-98-36); Securities Exchange Act Release No. 40026 (May 26, 1998), 63 FR 30789 (June 5, 1998) (File No. SR-NASD-97-34); Securities Exchange Act Release No. 40252 (July 23, 1998), 63 FR 40759 (July 30, 1998) (File No. SR-NASD-98-46).

<sup>18</sup> See, e.g., File No. SR-NASD-98-88 (revising listing and delisting procedures).

<sup>19</sup> Proposed Rule 9511. The pre-use advertising requirements are set forth in proposed Rules 2210 and 2220

<sup>23</sup> The confidential documents are listed in Rule 9521. This provision is based upon a provision currently found in Rule 9514(e).

<sup>24</sup> The NASD Board generally meets every two months.

the members of the NASD Board Executive Committee and the Governor who called the proceeding for review. The Governor who called the review would serve in lieu of an Executive Committee member who has the same classification (Industry, Non-Industry, or Public) as the calling Governor. NASD Regulation states that it would design procedures for selecting the Executive Committee member excused in such a way to prevent his or her exclusion from every panel.

NASD Regulation believes the review panel composition is also consistent with the SEC Order because a respondent in a proceeding will still have the benefit of a balanced body conducting the review. Pursuant to NASD By-Laws, as revised to be consistent with the SEC Order, the NASD Board Executive Committee must reflect the percentages of Non-Industry and Public Governors on the NASD Board. The percentage would be maintained on the review panel by having the Governor initiating the call for review serve as a substitute for an Executive Committee member of the same classification.

*c. Reinstatement Provisions.* The reinstatement provisions set forth in proposed Rule 8225 are amended to provide that requests to terminate a suspension should be filed with the Department of Enforcement. If the Department of Enforcement denies the request, a further request for relief may be filed with the NASD Regulation Office at General Counsel. If the request is filed within 30 days after service of the underlying suspension decision, the review panel that made the underlying suspension decision shall render the termination of suspension decision. NASD Regulation notes that the review panel would be most familiar with the decision and the issues during this period. If the request is filed more than 30 days after service of the underlying suspension decision, the NAC shall render the termination of suspension decision. NASD Regulation believes this will ensure that the review panel's responsibilities are concluded shortly after its decision is rendered and will not continue for an indefinite period.

*d. Public Disclosure.* Proposed Interpretive Material 8310-2 provides for the release of disciplinary information to the public. The proposed rule change is amended to permit the NASD to release information about suspensions and cancellations imposed under the Rule 8220 Series, unless the NAC determines otherwise. NASD Regulation explained that the NAC may determine not to release such information if a member subject to a

suspension quickly cures the failure to provide information and the suspension is quickly terminated.

### 3. Statutory Disqualification

*a. Member Obligations.* The proposed amendments clarify certain procedures and expedite statutory disqualification proceedings, necessary to protect investors. Proposed Rule 9522(b) provides that a member has an independent obligation to initiate a statutory disqualification proceeding. Proposed Rule 9522 provides that if a member fails to respond to a statutory disqualification notice by filing a written request for relief within ten days, the member's membership may be canceled and the associated person's registration may be revoked, unless an extension of time is granted by the NAC for good cause shown.

*b. Expedited Review.* Proposed Rule 9525 provides for expedited review of statutory disqualification proceedings when the Statutory Disqualification Committee requests an expedited review and the NASD Board Executive Committee determines that such action is necessary for the protection of investors. The review panel shall be composed of the NASD Board Executive Committee, except that the Governor who called the review shall serve on the review panel in lieu of an Executive Committee member who has the same classification (Industry, Non-Industry, or Public) as the Governor. The procedures for selecting the Executive Committee member to be excused shall be designed in such a way as to prevent his or her exclusion from every panel. NASD Regulation believes this change will allow the eligibility proceeding to be concluded in a more timely manner for the protection of investors.

### 4. Failure To Pay Dues, Fines and Other Penalties

The proposed Rule 9530 Series sets forth procedures for suspending or canceling the membership of a member or the registration of an associated person for failure to pay fees, dues, assessments, or other charges. Procedures for such a cancellation or suspension are currently set forth in Rule 9510 Series. The proposed rule change provides that the NASD Treasurer is authorized to initiate such proceedings by sending a notice to the member or associated person. The hearing will be conducted by a hearing officer, who will be authorized to suspend or cancel the membership of a member or the registration of a person. The hearing procedures are modeled after proposed Rule 8220 Series.

The proposed rule change does not include a call for review because, according to NASD Regulation, the issues to be resolved in this type of proceeding are narrow and largely administrative. NASD Regulation believes that it is more efficient to have one hearing officer conduct the hearing and render a final decision. Moreover, NASD Regulation notes that hearing officers are well-suited to resolve the issues presented in hearings for failure to pay fees due to their training and experience in the NASD's disciplinary proceedings under the Rule 9200 Series and in non-summary proceedings for failure to pay arbitration awards under the Rule 9510 Series. Appeal to the Commission following completion of this proceeding is still available, however.<sup>25</sup>

### 5. General Procedures

The hearing and decision provisions in proposed Rule 9514 are also revised. First, proposed Rule 9514(a)(1) provides that a member or person who requests a hearing must set forth specific grounds for setting aside the notice rather than specifying the type of action the member seeks to reverse or oppose at the hearing. Second, the proposed rule provides that a member who receives notice of an advertising pre-filing requirement under Rule 2210 or 2220 has 30 days to request a hearing. Currently, Rule 9514 does not address pre-use filing requirements and any request for a hearing in a non-summary proceeding must be filed within seven days. According to NASD Regulation, the additional time is provided in advertising pre-use filing requirements because members may need additional time to consider whether to comply with or contest the requirements. Third, proposed Rule 9514(f)(5) authorizes the Office of Hearing Officers to act as custodian for non-summary proceedings for a failure to comply with an arbitration award or settlement agreement related to a NASD arbitration or mediation. Under Rule 9514(b)(1), hearing officers serve as the adjudicators in such proceedings, and according to NASD Regulation, the Office of Hearing Officers is the appropriate custodian in place of the NASD Regulation Office of General Counsel. Finally, proposed Rule 9514 has been amended to contain cross references to Rules 2210 and 2220.

Proposed Rule 9516 is amended to provide that requests for reinstatement may be made after either a summary or non-summary proceeding under the Rule 9510 Series. Currently,

<sup>25</sup> See Proposed Rule 9533.

reinstatement is available only after a non-summary proceeding.

### B. Streamlining of Default Decisions

The proposed amendments to Rules 9215, 9241, 9269, and 9312 are designed to clarify and consolidate the NASD Code of Procedure ("Code") default provisions, and to shorten the call for review period for default decisions to 25 days.

#### 1. Consolidation of Default Provisions

Currently, Rule 9269 is devoted exclusively to defaults resulting from a failure to appear at a hearing. Defaults, however, also occur as a result of failing to file an answer or as a result of failing to appear at a pre-hearing conference. The proposed amendments consolidate many of the default provisions in Rule 9269. Accordingly, proposed Rule 9269 will address defaults resulting from a failure to appear at a hearing, as well as a failure to answer a complaint and a failure to appear at pre-hearing conference.

The default rules have also been clarified by the proposed rule change. Proposed Rule 9269(b) clarifies that default decisions issued by hearing officers should contain the same information as decisions issued in litigated cases. Subsection (c) of proposed Rule 9269 provides that either the Review Subcommittee or the NAC may, upon filing a motion and a showing of good cause, set aside a default judgment. Furthermore subsection (d) of proposed Rule 9269 clarifies that default judgments must be appealed within 25 days after service of the decision, and that sanctions are effective 30 days after service of the decision (other than bars and suspensions which are effective immediately). These time periods are already set forth in Rules 9311(a) and 9360, respectively.

#### 2. Calls for Review by General Counsel

Proposed Rule 9312 is amended to shorten the period when the General Counsel may call a default decision for review. Currently, the General Counsel has 45 days to determine whether to call a default decision for review, which is the same call period for litigated decisions. Twenty-five days, however, is the period proposed for calling for review a default decision. NASD Regulation believes that the additional 20 days for the call decision is appropriate for litigated decisions because the NAC or the Review Subcommittee may prefer to wait and see if an appeal will be filed. According to NASD Regulation, appeals of default decisions, however, are infrequent, and

the call decisions generally are made within the 25 day period. NASD Regulation believes that shortening the call period for default decisions is practicable, and will have the effect of putting default decisions (which often involve bars and expulsions) into effect sooner.

### C. Modification of Pre-Use Filing Requirements

In addition to amending the procedures under which pre-use filing requirements are imposed, the NASD also proposes to amend the substantive provisions in Rules 2210(c)(4) and 2220(c). These rules require members to file advertisements, sales literature, and educational materials before they are used. The Rules currently provide that a District Business Conduct Committee ("DBCC") may impose pre-use filing requirements and may conduct a hearing if the member opposes the pre-use requirement. These provisions, however, are consistent with the SEC Order<sup>26</sup> and therefore, have not been utilized since August 1996. The proposed rule change would vest authority to impose a pre-use filing requirement solely with the NASD Regulation staff, specifically the Advertising/Investment Companies Regulation Department. Moreover, any hearing requested regarding the requirement would be conducted by a hearing officer or other adjudicator, as set forth in the non-summary proceedings of the Rule 9510 Series, rather than by DBCC.

### D. Refinement of Disciplinary Process

#### 1. Amendment of Complaints Prior to Responsive Pleadings

The proposed change to Rule 9212 will enable the Department of Enforcement to amend complaints once as a matter of course, without hearing officer approval, prior to the filing of responsive pleadings. The current rule requires the Department of Enforcement to file a motion to amend any complaint, and the hearing officer must grant such motion before a complaint can be amended. NASD Regulation notes that generally such motions are granted if filed before responsive pleadings are filed. NASD Regulation believes the motion requirement for the first amendment can be eliminated without unfairness to respondents, and that the change is consistent with most judicial practice.<sup>27</sup>

<sup>26</sup> SEC Order, *supra* note 13.

<sup>27</sup> Amendment No. 5 notes that this practice is consistent with the Federal Rules of Civil Procedure.

#### 2. Introduction of New Evidence Upon Review

Proposed Rule 9346(b) would impose a requirement that motions to introduce new evidence in appealed or called cases be made within 30 days of service of the index to the record as required under Rule 9321. Rule 9346(b) currently requires that motions to introduce new evidence in a NAC proceeding be made within 30 days of service of the notice of appeal (or within 35 days of service of notice of a call for review). NASD Regulation believes, however, that a motion to introduce new evidence generally can be best made after the parties have received copies of the official index to the record.

### E. Miscellaneous Technical Revisions

#### 1. Issuance of Decisions in Settled Cases

Proposed Rule 9270 establishes that the issuance of decisions, in settled cases, is to be done by the General Counsel. Rule 9270 currently requires that decisions relating to accepted offers of settlement be issued by the Office of Hearing Officers. According to NASD Regulation, returning decisions relating to offers of settlement to the Office of Hearing Officers after acceptance by the NAC only introduces delay and the possibility of error. Moreover, NASD Regulation believes the proposed rule change will clarify that the Hearing Officers do not have authority to approve offers of settlement.

#### 2. Effectiveness of Sanctions

The proposed amendments to Rule 9360 generally provide that sanctions will continue to become effective 30 days after the date of service of the decision constituting final disciplinary action. The date, however, will no longer be established by the Chief Hearing Officer. NASD Regulation is proposing this change because the Chief Hearing Officer plays no part in the final stages of an appealed or called disciplinary proceeding. Proposed Rule 9360 also incorporated references to Rules 9349 and 9351 to clarify Proposed Rule 9360's applicability.

#### 3. Reference to National Adjudicatory Council

NASD Regulation is proposing to amend definition (m) of Association Rule 0120 to reflect that the NAC has replaced the National Business Conduct Committee ("NBCC"). The NAC is a committee of NASD Regulation that acts on behalf of the NASD Regulation Board of Directors with respect to disciplinary and related procedures.

NASD Regulation noted that the NAC replaced the NBCC pursuant to

corporate reorganization. The revision to the corporate structure were approved on November 14, 1997.<sup>28</sup> Related changes to the rules describing the NAC's functions in disciplinary proceedings and related matters were approved on December 19, 1997.<sup>29</sup>

#### 4. Location of Testimony

NASD Regulation proposes to amend Rule 8210 to clarify that Association staff may specify the location at which a member, associated person, or other person subject to the Association's jurisdiction must testify for the purpose of an investigation, complaint, examination, or proceeding. NASD Regulation stated that its authority to specify a location has been recently questioned and believes the proposed rule change will clarify the Association's authority.

### IV. Comments and Responses

The Commission received one comment letter regarding the proposed rule change.<sup>30</sup> Overall, the commenter agrees with the proposed rules, but believes the rules could be improved or supplemented in certain respects.

#### A. Proposed Rule 9212

The Flannery Letter suggested amending proposed Rule 9212. Proposed Rule 9212, as originally submitted and noticed, sought to enable the Department of Enforcement unlimited discretion to file amendments to complaints before responsive pleadings have been filed. As originally submitted, proposed Rule 9212 would have allowed the Department of Enforcement to file unlimited amendments without hearing officer approval.<sup>31</sup> The Flannery Letter suggested that NASD Regulation be limited to a single amendment before the filing of responsive pleadings. The Flannery Letter noted that the Federal Rules of Civil Procedure limit parties to one amendment of right before responsive pleadings are filed.<sup>32</sup>

NASD Regulation agrees with the Flannery Letter and proposes to amend proposed Rule 9212 to limit the Department of Enforcement to one amendment as a matter of course before responsive pleadings are filed.<sup>33</sup> The

revised Rule 9212(b) follows. Additions are *italicized*; deletions are [bracketed].

#### 9212. Complaint Issuance— Requirements, Service, Amendment, Withdrawal, and Docketing

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#### (b) Amendments to Complaint

The Department of Enforcement may file and serve an amended complaint that includes new matters of fact or law *once as a matter of course* at any time before the Respondent answers the complaint. *Otherwise* [After the Respondent answers], upon motion by the Department of Enforcement, the Hearing Officer may permit the Department to amend the complaint to include new matters of fact or law, after considering whether the Department of Enforcement has shown good cause for the amendment.

#### B. Proposed Rule 9215

The Flannery Letter also suggested that Rule 9215 arguably could shorten the time period by which responsive pleadings are to be filed. Rule 9215(e) sets forth the time requirements for responsive pleadings. Currently, Rule 9215(e) requires that upon amendment of a complaint, the time for filing an answer is extended to 14 days after service of the amended complaint. The commenter pointed out that this could lead to the respondent having less time to respond than they would have been allowed if the complaint had not been amended.<sup>34</sup>

NASD Regulation agrees that Rule 9215(e) could have the effect described by the commenter. NASD Regulation responds, however, that this was not its intent. In response, NASD Regulation proposes to amend Rule 9215(e) to clarify that the time period by which responsive pleading are considered timely shall not be shortened by the filing of an amended complaint by the Department of Enforcement. The text of proposed rule 9215(e) follows. Additions are *italicized*; deletions are [bracketed].

#### 9215. Answer to Complaint

##### (a) Form, Service, Notice

Pursuant to Rule 9133, each Respondent named in a complaint shall serve an answer to the complaint on all other Parties within 25 days after service of the complaint on such Respondent, and at the time of service shall file such answer with the Office of Hearing Officers pursuant to 9135, 9136, and 9137. The Hearing Officer assigned to a disciplinary proceeding pursuant to Rule 9123 may extend such period for good cause. Upon receipt of a Respondent's answer, the

Office of Hearing Officers shall promptly send written notice of the receipt of such answer to all Parties.

\* \* \* \* \*

#### (e) Extension of Time To Answer Amended Complaint

If a complaint is amended pursuant to Rule 9212(b), the time for filing an answer or amended answer shall be *the greater of the original time period within which the Respondent is required to respond, or* [extended to] 14 days after service of the amended complaint. If any Respondent has already filed an answer, such Respondent shall have 14 days after service of the amended complaint, unless otherwise ordered by the Hearing Officer, within which to file an amended answer.

\* \* \* \* \*

#### C. Rule 9268

Finally, the Flannery Letter made a recommendation that was unrelated to the proposed rule filing. The recommendation related to the determination of the time period when a hearing panel shall complete a decision. Currently, Rule 9268(a) provides that a hearing officer shall prepare a majority decision within 60 days of the "final date allowed for filing proposed findings of fact, conclusions of law, and post-hearing briefs, or by a date established at the discretion of the Chief Hearing Officer." The Flannery Letter contends that when the 60 day period runs from a date established by the chief hearing officer, a respondent has no way of knowing when a majority decision will be rendered. The Flannery Letter suggested that the chief hearing officer inform the parties of the date chosen to begin the 60 day period if it is different from the final date for all post-hearing filings.

NASD Regulation has agreed to adopt a written policy pursuant to which it will send a letter to respondents informing them if a decision will not be prepared approximately 60 days after receipt of the transcripts or post hearing submissions, whichever is later. NASD Regulation believes that the issue is when the parties will receive a decision, not the starting date selected by the chief hearing officer.

### V. Discussion

The Commission finds that the proposed rule change, as amended, is consistent with the Act and the rules and regulations thereunder applicable to a national securities association.<sup>35</sup> In particular, the Commission finds that the proposed rule change is consistent

<sup>35</sup> In reviewing this proposal, the Commission has considered its impact on efficiency, competition, and capital formation. 15 U.S.C. 78c(f).

<sup>28</sup> Release No. 34-39326, *supra* note 10.

<sup>29</sup> Securities Exchange Act Release No. 39470 (December 19, 1997), 62 FR 67297 (December 30, 1997) (File No. SR-NASD-97-81).

<sup>30</sup> Flannery, *supra* note 9.

<sup>31</sup> Currently, the Department of Enforcement must move to amend any complaint and a hearing officer must grant the motion before the complaint can be amended.

<sup>32</sup> See Federal Rule of Civil Procedure 15(a).

<sup>33</sup> See Amendment No. 5.

<sup>34</sup> An answer must be served on all of the parties within 25 days of service of the complaint. Rule 9215(a).

with the requirements of Sections 15A(b)(2), 15A(b)(6), 15A(b)(7), and 15A(b)(8) of the Act.<sup>36</sup>

Section 15A(b)(2) requires national securities associations to have the capacity to enforce compliance by their members and persons associated with members, with the provisions of the Act, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board, and the rules of the association.

Generally, the proposed rule change modifies the disciplinary procedures of the Association to enhance its membership oversight capabilities. For example, the proposed changes to Rules 2210 and 2220 pre-use filing requirements, which replace DBCC action with that of the NASD Regulation staff, should provide a more independent and unbiased regulation and oversight of these matters. The proposed changes to Rule Series 8220 in providing and clarifying the procedures applied when members or associated person fail to provide requested information further the Association's ability to deal with these matters. Finally, the proposed changes to Rule 9510 Series in simplifying and consolidating the disciplinary procedures for summary and non-summary proceedings similarly enhance the Association's capacity and authority to enforce the provisions of the Act, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board, and the Rules of the Association.

Section 15A(b)(6) provides, among other things, that the Rules of the Association must be designed to prevent fraudulent and manipulative acts and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest.<sup>37</sup> The proposed rule change is consistent with the provisions of this section because, for example, the changes to the Rule 9520 Series should enhance investor protection by enabling more rapid identification of statutorily disqualified individuals. The proposed amendments expressly identify a member's obligation to initiate a statutory disqualification proceeding if it or one of its employees is subject to a statutory disqualification; and expedite review of statutory disqualification proceedings by streamlining the process for requesting

expedited review.<sup>38</sup> Similarly, the enhanced statutory disqualification provisions should help to prevent fraudulent and manipulative act and practices, to promote just and equitable principles of trade, to remove impediments to and perfect the mechanism of a free and open market and a national market system, and, in general, to protect investors and the public interest by ensuring that members and associated persons are qualified and eligible for membership and when necessary, seeks to ensure prompt disqualification.

Moreover, proposed Interpretative Material 8310-2 is also consistent with the provision of Section 15A(b)(6) because it allows prompt release of disciplinary information to the public. The Commission believes disseminating disciplinary information to the public serves to prevent fraudulent and manipulative acts and practices and protects investors and the public interest by acting as a deterrent to violating the rules of the Association. The Commission also believes that publication of disciplinary information also serves to notify the public of those persons who have committed rule violations.

Section 15A(b)(7) requires that members and persons associated with members be appropriately disciplined for violation of any provision of the Act, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board, or the rules of the association.<sup>39</sup> Proposed Rule 8220 Series provides for appropriate discipline for the failure to provide requested information. If a member fails to provide requested information, the NAC may suspend or cancel the member. The proposed Rule 9510 Series also provides for the appropriate discipline of members. This series governs certain summary and non-summary proceedings such as, among other things, summary proceedings authorized by Section 15A(h)(3) of the Act, non-summary proceedings to suspend or cancel a member for failing to comply with an arbitration award, or for failing to meet qualification requirements or if a member cannot be permitted to continue to have access with safety to investors, creditors, members, or the Association. The proposed rule change is consistent with Section 15A(b)(7) of the Act, as shown by these examples, because it provides

an appropriate mechanism for disciplining members and persons associated with members for violations of the Act, the rules and regulations thereunder, the rules of the Municipal Securities Rulemaking Board, and the rules of the Association.

Finally, Section 15A(b)(8) of the Act requires that the rules of the association provide a fair procedure for the disciplining of members and person associated with members.<sup>40</sup> The proposed rule change is consistent with the provisions of this section. For example, the review procedures of the Rule 8220 Series, which addresses the procedure for suspending or canceling a member for failing to provide requested information, have been revised to enhance the fair discipline of members.

Currently, decisions of the appointed subcommittee are reviewed by the full NASD Board. Proposed Rule 8223(b) is revised to place the review authority with the NASD Board Executive Committee. The call for review by any governor, however, remains intact but is also revised. If a governor calls a decision for review, that governor shall serve on the NASD Board Executive Committee to review the decision. That governor shall serve in place of an executive committee member who shares the same classification (Industry, Non-Industry, or Public) as the calling governor. The Commission believes that by having the calling governor serve on the review committee, the governor should be able to more fully develop and investigate the reasons why he or she called the decision for review.

The Commission also notes that the procedure for the calling governor to serve on the review panel ensures that a balanced panel will conduct the review. The percentages of executive committee members remain intact as the calling governor is appointed to serve as a substitute for an executive committee member of the same classification. These revisions should provide members with more balanced and fair procedures for reviewing cancellation and suspension decisions.<sup>41</sup>

In addition, the proposed change of the review panel should also foster fairness in disciplinary proceedings. By placing the review authority with the NASD Board Executive Committee,

<sup>40</sup> 15 U.S.C. 78o-3(b)(8)

<sup>41</sup> The Commission notes that the changes in the procedures of a call for review by a governor set forth in Rule 8223 are also proposed in Rule 9525. Proposed Rule 9525 addresses expedited reviews of statutory disqualifications and contains the same procedures as proposed Rule 8223. The Commission finds that the proposed changes to Rule 9525 are also consistent with Section 15A(b)(8) for the reasons set forth above for proposed Rule 8223.

<sup>36</sup> 15 U.S.C. 78o-3(b)(2); 15 U.S.C. 78o-3(b)(6); 15 U.S.C. 78o-3(b)(7); and 15 U.S.C. 78o-3(b)(8).

<sup>37</sup> 15 U.S.C. 78o-3(b)(6).

<sup>38</sup> Under the Proposal, as approved, the Statutory Disqualification Committee can request expedited review by the NASD Executive Committee if such action is necessary for the protection of investors.

<sup>39</sup> 15 U.S.C. 78o-3(b)(7).

proceedings should be concluded in a more timely manner. As NASD Regulation noted, the NASD Board Executive Committee is a smaller body designed to meet on an as-needed basis that can convene more easily than the NASD Board.

Proposed Rule 9212 is also consistent with the requirements of Section 15A(b)(8). The rule is amended to provide that the Department of Enforcement is entitled one amendment of a complaint, as a matter of course, before responsive pleadings are filed. The Commission finds that this ensures fairness of disciplinary procedures by expediting pre-hearing proceedings by deleting the requirement of hearing officer approval for the first amendment. Respondents are also protected. By requiring hearing officer approval of all subsequent amendments, respondents will not be subject to unchecked delays caused by unlimited amendments.

The proposed changes to the Rule 9530 Series also help ensure that disciplinary procedures are fair. The proposed Rule 9530 Series sets forth the procedures for suspending or canceling the membership of a member or the registration of an associated person who fails to pay fees, assessments, or other charges. Under this rule series, a hearing officer conducts the hearing and makes the final decision as to canceling or suspending the membership of a member or the registration of a person. NASD Regulation notes that there is no call for review of a hearing officer decision because the issues resolved are narrow and largely administrative.

The Commission finds that the procedures set forth in the proposed Rule 9530 Series promote fair disciplinary procedures. The proposed rule change consolidates and clarifies the procedures for failure to pay dues, assessments, or other charges. Having the same hearing officer conduct the hearing and render the decision provides members with expedited review and prompt resolution of claims.

The Commission finds good cause for approving Amendments No. 5 to the proposed rule change before the thirtieth day after the date of publication of notice thereof in the **Federal Register**.<sup>42</sup> As discussed in Section IV above, Amendment No. 5 revises proposed Rules 9212 and 9215. The amendment to proposed Rule 9212

states that the Department of Enforcement shall be able, once as a matter of course, to amend complaints with hearing officer approval before a respondent files an answer. The original proposal allowed the Department of Enforcement unlimited amendments to complaints without hearing officer approval. The amended proposed rule should prevent unnecessary delays in proceedings and ensure fairness by providing hearing officer oversight of multiple amendments.

The amendment to proposed Rule 9215 provides that if the Department of Enforcement amends a compliant the respondent shall not be affected by a shorter time period in which to answer. The amended proposal clarifies that the respondent will either be afforded the full remaining period allowed under Rule 9215(a) or fourteen days from service of the amended complaint, whichever is greater. The amended proposed rule change promotes fairness because it protects a respondent's ability to adequately answer complaints by ensuring that he has sufficient time.

For these reasons, the Commission believes that good cause exists, consistent with Section 19(b) of the Act,<sup>43</sup> to approve Amendment No. 5 to the proposed rule change on an accelerated basis.

#### VI. Solicitation of Comments

Interested persons are invited to submit written data, views, and arguments concerning Amendment No. 5. Persons making written submission should file six copies thereof with the Secretary, Securities and Exchange Commission, 450 Fifth Street, N.W., Washington, D.C. 20549. Copies of the submission, all subsequent amendments, all written statements with respect to the proposed rule change that are filed with the Commission, and all written communications relating to the proposed rule change between the Commission and any other person, other than those that may be withheld from the public in accordance with the provisions of 5 U.S.C. 552, will be available for inspection and copying at the Commission's Public Reference Room. Copies of such filing will also be available for inspection and copying at the principal office of the NASD. All submissions should refer to file No. SR-NASD-98-57 and should be submitted by January 26, 1999.

<sup>43</sup> 15 U.S.C. 78s(b).

#### VII. Conclusion

*It is therefore Ordered*, pursuant to Section 19(b)(2) of the Act,<sup>44</sup> that the proposed rule change, as amended, (SR-NASD-98-57) is approved.

For the Commission, by the Division of Market Regulation, pursuant to delegated authority.<sup>45</sup>

**Margaret H. McFarland,**

*Deputy Secretary.*

[FR Doc. 99-77 Filed 1-4-99; 8:45 am]

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#### SECURITIES AND EXCHANGE COMMISSION

[Release No. 34-40847; File No. SR-NYSE-98-32]

#### Self-Regulatory Organizations; Notice of Extension of the Comment Period for the Proposed Rule Change by the New York Stock Exchange, Inc. Relating to Shareholder Approval or Stock Option Plans

December 28, 1998.

On October 13, 1998, the New York Stock Exchange, Inc. ("NYSE" or "Exchange") filed with the Securities and Exchange Commission ("SEC" or "Commission"), a proposed rule change, pursuant to Section 19(b)(1) of the Securities Exchange Act of 1934<sup>1</sup> and Rule 19b-4 thereunder,<sup>2</sup> to amend the Listed Company Manual (the "Manual") regarding the Exchange's shareholder approval policy (the "Policy") with respect to stock option and similar plans ("Plans"). A complete description of the proposed rule change is found in the notice of filing which was published in the *Federal Register* on November 16, 1998.<sup>3</sup>

In response to the solicitation of comments, the Commission received a request to extend the comment period.<sup>4</sup> Given the public's interest in the proposed rule change and the Commission's desire to give the public sufficient time to consider the proposal, the Commission has decided to extend the comment period pursuant to Section 19(b)(2) of the Act.<sup>5</sup> Accordingly, the

<sup>44</sup> 15 U.S.C. 78s(b)(2).

<sup>45</sup> 17 CFR 200.30-3(a)(12).

<sup>1</sup> 15 U.S.C. 78s(b)(1).

<sup>2</sup> 17 CFR 240.19b-4.

<sup>3</sup> Securities Exchange Act Release No. 40679 (November 13, 1998) 63 FR 64304 (November 19, 1998) ("Release"). The notice also solicited comment on several specific issues. See Section IV of the Release.

<sup>4</sup> See Letter from Sarah Teslik, Council of Institutional Investors, to Jonathan G. Katz, Secretary, SEC, dated November 20, 1998. As originally noticed, the comment period expired on December 10, 1998.

<sup>5</sup> 15 U.S.C. 78s(b)(2).

<sup>42</sup> The Commission notes that Amendment Nos. 3 and 4 are non-substantive amendments granting the Commission extensions of time to act which do not require publication for notice and comment. Amendment No. 6 is also a non-substantive amendment changing the effective date of the proposed rule change which does not require publication of notice and comment.